ANDREWS KURTH LLP
450 Lexington Avenue
New York, New York 10017
(212) 850-2800
Peter S. Goodman (PG 3939)
Justin R. Wyatt (JW 9775)

Attorneys for Wells Fargo & Company and
Vulcan Ventures Inc.

Hearing Date: June 22, 2004

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	Chapter 11
RCN CORPORATION, et al.,	Case No.: 04-13638
Debtors.	(Jointly Administered)

OBJECTION OF PREFERRED SHAREHOLDERS WELLS FARGO & COMPANY AND VULCAN VENTURES INC. TO DEBTORS' MOTION FOR ORDER UNDER 11 U.S.C. §§ 105(a), 363(b), 364(c)(1), 503(b) AND 507 AUTHORIZING, APPROVING AND RATIFYING EXIT FINANCING COMMITMENTS AND PAYMENT OF RELATED FEES AND EXPENSES

Wells Fargo & Company and Vulcan Ventures Inc. (together, the "Shareholders"), substantial holders of RCN Corporation ("RCN") preferred stock, by and through its undersigned counsel, Andrews Kurth LLP, hereby make the following Objection to Debtors' motion (the "Motion") for entry of an order under 11 U.S.C. §§ 105(a), 363(b), 364(c)(1), 503(b) and 507 authorizing, approving and ratifying the senior secured commitment letter (the "Commitment Letter") detailing the commitment of certain lenders ("Lenders") to provide exit financing ("Exit Facility").

PRELIMINARY STATEMENT

1. The Motion should not be approved at this time as its filing is grossly premature. This case is weeks old. Parties in interest, such as the Shareholders, have not had time to fully review the company's finances or analyze the proposed Exit Facility within a possible restructuring. Although the Exit Facility will not close until a plan is confirmed, the Debtors have not even filed a plan of reorganization or disclosure statement. As a result, there is little or no context to analyze the Exit Facility. Moreover, the Debtors seek approval of the Motion on inadequate notice.[1] The Debtors' rush to cement the Exit Facility into place at this early stage is an impermissible attempt to implement their plan of reorganization while circumventing the protections 11 U.S.C. §1129 affords parties in interest, such as the Shareholders.

2. The Debtors have made clear that the Exit Facility is an important step in moving forward with the plan of reorganization they have outlined in various filings (the "Outline Plan"). Therefore, gaining approval of Exit Facility prior to filing and confirming the Outline Plan is highly prejudicial to parties that may object to such a plan. This is especially true where there are parties for whom a potential sale of the company or a valuation dispute might result in recoveries substantially higher than those provided for in the Outline Plan. Such a creeping, or *sub rosa*, plan is not authorized under Section 363 of the Bankruptcy Code.

3. Moreover, the Exit Facility may be unnecessary and creates a penalty potentially in excess of $14 million for moving forward with alternatives to the Outline Plan. The Exit

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[1] The Debtors failed to comply with the noticing requirements of the Federal Rules of Bankruptcy Procedure. Motions under Section 363(b) require 20 days' notice plus 3 days for mailing. Fed.R.Bankr.P. 2002. Further, in the Motion, the Debtors acknowledge that "pursuing approval of the Exit Financing Commitments at this early stage of the proceedings … [is] uncommon." *See* Motion, at ¶ 27. The Debtors only provided merely 18 days' notice and therefore failed to comply with noticing requirements. Despite their statement that a motion to approve exit financing may be premature, the Debtors refused to grant the Shareholders an adjournment of the hearing.

Facility will only be used if a plan of reorganization similar to the Outline Plan is approved. Other potential plans, such as a possible sale of the company, may have no use for the Exit Facility. However, the Debtors would still have to pay in excess of $14 million if the Motion is approved. Such a large penalty creates an unfair disincentive that will chill the consideration of alternates to the Outline Plan. Further, in the event that an alternative to the Outline Plan is approved, the $14 million penalty could constitute all or a substantial portion of the recovery that might be available to the Shareholders.

4. Finally, contrary to the spirit of the term "commitment," the current form of the Commitment Letter in the Exit Facility does not represent a firm commitment by the Lenders to provide funds. The Exit Facility provides various discretionary measures pursuant to which the Lenders can opt out of funding due to circumstances outside the Debtors' control. For example, the "market-out" provision in the Exit Facility allows the Lenders not to provide funds if there is "an adverse change in, financial, banking or capital markets that could materially impair the syndication." *See* Motion, Exhibit A. Obviously, if the Lenders are able to opt out if the market changes, the Debtors' stated reason for locking financing at this time (*i.e.*, favorable market conditions) goes out the door. Therefore, the only reason for moving forward with the Motion at this time is too seal in place the Outline Plan and deprive parties in interest, such as the Shareholders, and meaningful say or return in this bankruptcy.

A. THE MOTION IS NOT APPROPRIATE OR NECESSARY AT THIS STAGE OF THE DEBTORS' CHAPTER 11 CASES

5. Since the bankruptcy is but a few weeks old, it is difficult to fathom a legitimate reason for putting the Exit Facility in place. Neither the Shareholders nor other equity holders were consulted by the Debtors in the formulation of the Outline Plan, and the Shareholders do not support it in its current form; the banks and the Noteholders' Committee were the only

constituencies privy to the negotiations. In fact, the Debtors themselves confess that "pursuing approval of the Exit Facility at this early stage of the proceedings may be uncommon." *See* Motion, at ¶27. The Debtors have yet to commence substantive negotiations with the equity constituencies, evaluate whether the value of the reorganized company would provide greater value to equity holders or whether an outright sale serves the best interests of all creditors, file or schedule a hearing for a disclosure statement or plan of reorganization, or complete audited financial statements or file a liquidation analysis in support of a plan. Under these circumstances, obtaining $460 million in exit financing places the cart before the horse.

B. THE FEES ARE EXCESSIVE

6. Immediately upon approval of the Exit Facility, the Debtors will incur substantial fees, regardless of whether the Exit Facility is actually used. Moreover, the terms and amounts are not fully disclosed. In total, a potential of over $14 million in fees could go to waste, including a $4.6 million in termination fees (Motion, at ¶ 31), a break-up fee of $6.9 million (*Id.*),[2] a commitment fee of $2.3 million (*Id.*), and a non-refundable work fee of $250,000 (*Id.*). Exit facilities often go forward without termination fees. Moreover, a termination fee of 1% is substantially higher then is necessary or is provided for in other exit facilities. In sum, the total penalty for not going forward with the Exit Facility could be in excess of 3% of the Exit Facility, which is clearly excessive at this premature date. This $14 million penalty is in addition to the $16 million that will be paid to the Blackstone Group LLP and AP Services, Inc. in connection with the Outline Plan.

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[2] The break-up fee will have to paid if the Debtors move forward with financing other than through the Exit Facility. By way of example, this could happen if it turns out that more funding is needed than is provided in the Exit Facility and a second group of lenders provides this funding.

7. While the Debtors also argue that the fees to be paid under the Exit Facility are fair and reasonable and were negotiated in good faith and at arm's length (*See* Motion, at ¶ 40-41), this is nothing but conjecture. It is impossible for the Debtors to predict the state of the credit market when they are truly ready to move forward with a negotiated plan. In any event, given that there are many parties vying to provide exit financing, there is no reason to think that the terms of exit financing the Debtors may receive at a later date would substantially differ from the terms of the Exit Facility. Given that exit financing may not be required in the event of a sale, the justification that the Debtors are able to obtaining more favorable financing at this time may prove irrelevant. Alternatively, a different facility might be appropriate under a different reorganization plan (*i.e.,* a plan involving an equity infusion or change of current management).

C. THE DEBTORS SEEK TO EFFECTUATE A *SUB ROSA* PLAN

8. Approval of the Exit Facility would facilitate a *sub rosa* plan. It is true that any proposed use of estate assets under section 363 of the Bankruptcy Code must be supported by the sound business judgment of management. *See Committee of Equity Security Holder v. Lionel Corp. (In re Lionel Corp.),* 722 F.2d 1063, 1071 (2d Cir. 1983); *In re Paola Gucci*, 126 F.3d 380, 387 (2d Cir. 1997); *Official Committee of Unsecured Creditors of LTV Aerospace and Defense Co. v. LTV Corp. (In re Chateaugua Corp.)*, 973 F.2d 141 (2d Cir. 1992); *In re Global Crossing Ltd.,* 295 B.R. 726, 743 (Bankr. S.D.N.Y. 2003); *In re Ionosphere Clubs, Inc.,* 100 B.R. 670, 675 (Bankr. S.D.N.Y. 1989).

9. Notwithstanding this liberal standard, this Court must evaluate the actions of management in light of the particular circumstances of this case. As articulated by the Second Circuit, the bankruptcy court must, in considering the use, sale, or lease of the debtor's assets:

> consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike. He might, for example, look to

> such relevant factors as the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, **the likelihood that a plan or reorganization will be proposed and confirmed in the near future**, the effect of the proposed disposition on future plans or reorganization, the proceeds to be obtained from the disposition *via-a-vis* any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value. This list is not intended to be exclusive, but merely to provide guidance to the bankruptcy judge.

Lionel, 722 F.2d at 1071 (emphasis added).

10. In particular, it is well established pursuant to section 363 that a court may reject a proposed transaction that is intended "to short circuit the requirements of a reorganization plan by establishing the terms of the plan *sub rosa* in connection" with a proposed transaction.[3] *Pension Benefit Guaranty Corp. v. Braniff Airways, Inc, In re Braniff Airways, Inc.),*, 700 F.2d 935, 945 (5th Cir. 1983); *see also Institutional Creditors of Continental Air Lines, Inc. v. Continental Air Lines, Inc. (In re Continental Air Lines, Inc.),* 780 F.2d 1223, 1223, 1226 (5th Cir 1986) ("The issue . . . is how far a debtor-in-possession can stretch the bankruptcy laws to undertake transactions outside a plan of reorganization."); *In re Ionosphere Clubs, Inc., 100 B.R. 670 (*Bankr. S.D.N.Y. 1989*)* (evaluating whether sale of individual asset could be accomplished outside a plan of reorganization).

11. While the *sub rosa* plan issue normally arises in the context of asset sales, leases, and settlements, this reasoning is equally applicable whenever a particular transaction amounts to an element of a "creeping plan." *See, e.g., In re Washington-St. Tammany Electrical Cooperative, Inc.*, 97 B.R. 852 (E.D. La. 1989) (debtors' requested 16-month extension of

exclusivity would effectively determine the terms of an acceptable plan); *In re Copy Crafters Quickprint, Inc.*, 92 B.R. 973, 983 (Bankr. N.D.N.Y. 1988) ("[T]he approval of this lease will effectively put the Court's imprimatur on the sale [the lessee] and confirm the Plan long before the hurdles of Chapter 11 are overcome.").

12. The merit of committing to the Exit Facility at this time and at these costs must be evaluated within the context of these decisions. The Debtors are seeking approval of "commitments" to lend that only become effective if the Debtors confirm a plan reasonably acceptable to the Lenders. This plan, however, provides little or no benefit for the Shareholders. Moreover, approving the Exit Facility will serve to hinder the Shareholders' ability to argue against the Outline Plan and clearly results in a substantial penalty to formulating alternatives to the Plan. As such, the Exit Facility is by definition and effect a *sub rosa* plan.

D. THE EXIT FACILITY IS NOT A FIRM COMMITMENT

13. Contrary to the spirit of the term "commitment," the Commitment Letter falls far short of a firm pledge on Lenders' part to provide funds for implementation of a reorganization plan. Instead, the Commitment Letter supplies a laundry list of conditions, none of which is within the Debtors' control, but any of which could result in the Lenders opting out of providing funds.

14. Although the Debtors argue that the approval of the Exit Facility would provide them and other interested parties more certainty about Debtors' ability to complete a restructuring (*See* Motion, at ¶ 27), the Commitment Letter falls far short of providing such assurance. In fact, the Commitment Letter includes several provisions that, in summary, might result in funding commitments not being fulfilled. For instance, funding commitments may be cancelled if (a) there occurs or becomes known to Lender any condition or circumstance, which has had, or could reasonable be expected to have, a material adverse effect on the (x) Transaction

(as defined in the Commitment Letter), (y) the property, assets, nature of assets, business, operations, etc. of the Debtor, or (b) Lender not becoming aware (whether as a result of its due diligence analyses and review or otherwise) of any information not previously known to it which it believes is materially negative information with respect to the Transaction or the business, property, assets, nature of assets, operations, liabilities, condition (financial or otherwise) ….or which is inconsistent in a material and adverse matter with any such information or matter disclosed to Lender prior to the date of execution of the Commitment Letter. *See* Motion, Exhibit A. These conditions undermine the definiteness of the Exit Facility and represent the antithesis of a "funding commitment." As the Exit Facility stands, it adds no certainty whatsoever as to Debtors' ability to consummate a plan.

15. The Commitment Letter also includes a "market out" provision that excuses the funding commitment if there occurs "(x) a material adverse change to the syndication market for facilities similar in nature to the Credit Facilities, or (y) a disruption of, or an adverse change in, financial, banking or capital markets that could materially impair the syndication, placement and/or distribution of the Senior Secured Financing (or any component thereof). *See* Motion, Exhibit A.

16. This provision likewise provides Lenders with unfettered flexibility to dodge their commitments should the winds change ever so slightly. Debtors list the capital markets' receptiveness as one of their reasons for seeking approval of the Motion at this juncture and claim lack of any assurance that market conditions will not change for the worse. *See* Motion, at ¶ 27. The discretionary "market out" provision entirely undercuts this justification for approval of the Exit Facility. The Debtors should not be paying such a large commitment fee (See Section

B above) given Lenders' ability to terminate funding at their discretion based on a perceived change in market conditions.

E. THE DEBTORS CITE NO AUTHORITY FOR APPROVAL OF THE EXIT FACILITY AT THIS STAGE

17. In addition to articulating no compelling reason for approval of the Motion, the Debtors have cited to no case law that permits approval of exit financing before a plan is confirmed, and certainly not before a plan is even filed. While the Debtors state several times that they have demonstrated ample justification to enter into the proposed Exit Facility, these statements are clearly self-serving. The Motion does not even begin to explain why its is necessary or appropriate to put this funding in place at such early time in the bankruptcy and before evaluating alternatives for maximizing value of the Debtors.

18. The Debtors' citations to cases under 11 U.S.C. §§ 363(b) and 105 for the proposition that the entry into the Exit Facility is within their business judgment or within the powers of this Court is inapposite, since none of those cases involved approval of exit financing immediately after a bankruptcy filing.

19. The Debtors' citations (in ¶40) to cases approving exit financing so long as its negotiated in good faith and is in the best interests of the debtor are disingenuous. Both *In re Magnatrax Corp.,* 2003 WL 22807541 (Bankr. D. Del. 2003) and *In re Carmike Cinemas, Inc.,* Case No. 00-03302 (JBR), Docket No. 2085 (Bankr. D.Del. 2002) approved applications for exit financing as part of a plan of reorganization filed many months or even years after the initial bankruptcy filing. If anything, these cases support the Shareholders' position that consideration of exit financing should wait until a plan of reorganization is filed and all parties are heard.

WHEREFORE, for the reasons stated herein, the Shareholders respectfully request that the Court enter an order: (a) denying the Debtors' Motion, and (b) granting Shareholders such further relief as is just and proper.

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Respectfully submitted,

ANDREWS KURTH LLP

By: /s/ Peter S. Goodman
Peter S. Goodman (PG 3939)
450 Lexington Avenue
New York, NY 10017
Telephone: (212) 850-2800
Facsimile: (212) 850-2929

COUNSEL FOR WELLS FARGO & COMPANY AND VULCAN VENTURES INC.